

June 28, 2018

VIA Email

Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
10 Street, N.E.  
Washington, D.C., 20549-1090

Re: Notice of Filing and Immediate Effectiveness of the Twenty-Second Charges Amendment to the Second Restatement of the CTA Plan and the Thirteenth Charges Amendment to the Restated CQ Plan (Release No. 34-82071; File No. SR-CTA/CQ-2017- 04)

Dear Mr. Fields:

I appreciate the opportunity to submit comments in response to the above-referenced Notice of Filing and Immediate Effectiveness of the amendments to the CTA Plan and the CQ Plan published in the Federal Register on November 20, 2017. I write to recommend the Commission reject this pending application for a modification in data fees that would, by some measures, potentially increase fees for a product provider granted monopoly power by the government. In short, this comment letter suggests that a fee increase is inappropriate as it represents price discrimination prohibited by the statute, represents an inefficient abuse of government monopoly power, and at the very least is inappropriate at this time as the SEC stands on the cusp of major market structure reform that is only beginning in the recently proposed access fee pilot.

I presently serve as an Associate Professor of Law with tenure at the George Mason University Antonin Scalia Law School. I also serve on the Investor Advisory Committee of the Securities and Exchange Commission and am a member of the Market Structure Subcommittee of that Advisory Committee. I am writing in my individual capacity, and my views are my own.

My views are however informed by my work as a Professor of Securities Law. My views are also informed by my recent experience as Senior Counsel and Chief Economist to the House Committee on Financial Services, where I took academic leave from my teaching position to serve from May 2013 until April 2015 as an advisor to Chairman Hensarling on a variety of financial regulatory issues.

The SEC At A Minimum Should Wait On the Results of The Access Fee Pilot

The application's request for an effective data feed fee increase is inappropriate at this time, given that the SEC is in the midst of a dramatic rethinking of the market structure issue, and has only recently begun development of an access fee pilot to develop evidence to study allegations of rampant and systemic abuses in trading execution leveled in SEC studies, popular media, and pending litigation.

The transaction fee pilot recently proposed by the SEC stands to develop the necessary data to measure the impact of broker execution and alleged abusive trading practices in the execution of stock trading. The fee change requested by NYSE is entirely inappropriate at this time. The SEC should not consider fee reforms that will merely further entrench the current system as it simultaneously considers a dramatic overhaul of our market structure system.

Jonathan Macey, a noted corporate and securities law professor at Yale Law School, has described allegations of fraudulent trading practices systemic to our present market structure as where:

“Wall Street has developed a new way, clouded in obscurity, to fleece the hundreds of millions of Americans who have money invested in company pension plans, mutual funds and insurance policies... brokers routinely take kickbacks, euphemistically referred to as “rebates,” for routing orders to a particular exchange. As a result, the brokers produce worse outcomes for their institutional investor clients.”<sup>1</sup>

It has also been alleged that Exchanges share the rents they obtain through their market power over a number of facilities (including data fees), amidst the race to speed that high-speed traders utilizing those feeds have undertaken, with sources of order flow. A related initiative undertaken by the SEC in the access fee pilot stands to shed light on the role of rebates and access fees. Pending litigation in *City of Providence v. Nasdaq* has begun a process to bring those practices to light. The Commission should not narrowly consider individual, one off changes in fees without considering that fee design plays an important role in the broader market structure ecosystem.

One of the forms of arbitrage alleged to be abusive is SIP feed arbitrage. The Commission cannot be certain any approval in fee changes won't exacerbate this problem until the access fee pilot has been completed and the Commission has had time to digest the results of the pilot.

#### The Pending Proposal Would Further Entrench Monopoly Power, When The SEC Should Rethink The System Altogether

second major problem with this proposed fee change is that it represents an inappropriate exercise on government granted monopoly power. The market for data in the national securities markets have evolved into a monopolistic one characterized by rent seeking behavior on the part of dominant exchanges.

From the perspective of property rights theory, it was originally unclear whether trading data was appropriately considered the property of the exchanges matching trades, or the parties to the trades themselves. In the Securities Act Amendments of 1975 Congress essentially created by regulatory fiat a property right for the exchanges, and through rules adopted under that statute and subsequent rules it cemented a monopoly right to the data for the exchanges. On the other hand exchanges were

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<sup>1</sup> See Jonathan Macey and David Swenson, *Wall Street Profits by Putting Investors in the Slow Lane*, New York Times, 7/18/2007. Available at <https://www.nytimes.com/2017/07/18/opinion/wall-street-brokers-rebates-kickbacks.html>

regulated through requirements to provide data on terms that are “fair and reasonable,” “not unreasonably discriminatory” and represent an “equitable allocation of reasonable fees.”

This system is certainly suboptimal, and an alternative competitive system in which different providers of data could compete with each other would be preferable. Indeed, Commissioner Peirce observed in a recent speech before the SIFMA market structure conference that we should:

“look at current challenges in our equity markets from the outside, as it were, not accepting our current regulatory framework as a given that determines and constrains the limits of future possible market structure reforms...In a world where communications technology continues to enhance the flow of information and reduce the costs of transparency, is there any justification for the Commission’s command-and-control approach to regulating how orders interact and how investors communicate in the equity markets?”

The Commission’s consideration of the pending data fee application has implications for this kind of important rethink of our market structure. Though command and control structures are suboptimal, they are necessary as long as the market system features government created artificial demand for a monopoly product. Approving such a significant change in data fees would only serve to further entrench the current, suboptimal system by increasing barriers to entry for other firms attempting to institute alternative means of producing and disseminating data. While the fee application does not on its face purport to request a fee increase, it would effectively operate as a fee increase as it would expand application of non-display and access fees.

Instead the Commission’s attention would be better focused on Commissioner Peirce’s suggestion for reconsideration of market structure from the top down. Commissioner Peirce suggests that market structure regulation works best when it “creates a framework in which competitive forces function properly and that keeps barriers to entry low—if judiciously applied...”<sup>2</sup> Approval of the pending fee increase would do precisely the opposite and simply increase regulatory barriers to entry for competitors.

recent report by the Treasury Report considered aspects of market structure reform. The report noted that:

“Treasury recommends that the SEC also recognize that markets for SIP and proprietary data feeds are not fully competitive. The SEC has the authority under the Exchange Act to determine whether the fees charged by an exclusive processor for market information are “fair and reasonable,” “not unreasonably discriminatory,” and an “equitable allocation” of reasonable fees among persons who use the data.<sup>157</sup> The SEC

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<sup>2</sup> <https://www.sec.gov/news/speech/speech-peirce-041818>

should consider these factors when determining whether to approve SRO rule changes that set data fees.”<sup>3</sup>

Approval of the present fee increase would be highly counterproductive given the Treasury Department’s thought leadership in this area. Until such time as the SEC has had an opportunity to consider the many suggestions contained in the Treasury Report to provide for a more competitive market for data, the SEC should not approve increases in data feeds. Any fee changes now may make it more difficult for the SEC to institute big picture changes to make data provision more competitive in the future.

#### The Pending Proposal Violates Statutory Requirements

third major problem with this proposed fee change is that it appears to directly violate statutory requirements. It would appear that the pending fee proposal seeks to alter pricing structure to maximize the economic rents obtainable through monopoly power by instituting a form of discriminatory pricing model. NYSE is requesting a pricing model that charges data recipients based on the recipient’s marginal benefit from data use, rather than any additional marginal cost to NYSE in providing the data. That is the textbook definition of price discrimination, which appears to be prohibited by the statute.

Encouragement of a focus on marginal cost to the exchanges, rather than marginal benefit to the user, in fee increases was also at the heart of the DC Circuit’s ruling in *NetCoalition v. SEC*.<sup>4</sup> At a minimum, the SEC’s Division of Economic and Risk Analysis should conduct a study of the presence of monopoly power in data fees, and determine whether the proposed fee change would effectuate a form of discriminatory pricing unlikely to meet the SEC’s requirements for fee changes to be “fair” and non-discriminatory.

thank you for considering this comment letter.

Sincerely,

J.W. Verret

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George Mason University Antonin Scalia Law School

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<sup>3</sup> <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf> at 64.

<sup>4</sup> *NetCoalition v. SEC*, 615 F.3d 525 (D.C. Circuit 2010)